In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 396

FRED M. VINSON, DIRECTOR OF ECONOMIC STABILIZATION, BY CHESTER BOWLES, ADMINISTRATOR, OFFICE OF PRICE ADMINISTRATION, ET AL., PETITIONERS

v.

WASHINGTON GAS LIGHT COMPANY AND PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

REPLY MEMORANDUM FOR THE PETITIONERS

This memorandum is in reply to certain assertions of fact made in the brief for respondent Public Utilities Commission.

1. The Commission's brief repeatedly points out that the Commission refused to consider any factors entering into the determination of rates save those calculated in accordance with the sliding scale arrangement. See *e. g.*, pp. 22, 24, 28, 36. This description of the hearings accords with that contained in the Commission's brief in

opposition to certiorari (pp. 7, 14) quoted in our principal brief at p. 32. It accurately reflects the position of the Commission. Nevertheless, the Commission's brief now contains an argument (pp. 57–66) apparently resting on the contention that in fact the Commission did consider evidence sought to be introduced by petitioners on the question of a proper depreciation allowance. We pointed out in our principal brief the critical nature of this issue (pp. 36–44). Not only does it involve an issue of essential fairness between the Company and the consumers, but acceptance of the correction for depreciation allowance would alone have eliminated the rate increase granted by the Commission. In evident recognition of the importance of this evidence, the Commission's brief argues that it was rejected on the merits and not because of its lack of conformity to the sliding scale formula.

The short answer is that this contention comes too late. The record is clear that the majority of the Commission refused to consider, on the ground of irrelevance, evidence of a proper depreciation allowance both when it was sought to be elicited through cross-examination of the Commission's chief accountant (R. II, 390–391) and through examination of petitioners' expert (R. I, 165–166). Indeed, when the dissenting commissioner wished to pursue the subject, he was reminded by the chairman that the question of a proper depreciation allowance was a "question

which has been ruled out, not once, but at least three times in this proceeding" (R. I, 166). While, as we pointed out in our principal brief (p. 40), counsel for the company suggested that Exhibit 8 be admitted for whatever weight it might have, without waiving the objection to it, and the Commission acquiesced in the suggestion, the Commission refused to reinstate the testimony which had been stricken in so far as it related to depreciation (R. I, 182–183), and the opinion of the Commission indicates that no consideration was given to an adjustment of the sliding scale with respect to the depreciation allowance. In fact, neither the testimony of the Administrator's witness on this subject nor the subject itself was mentioned in the Commission's opinion (R. I, 39–55).

For the first time counsel for the Commission have now attempted to meet the proffered evidence on the merits. Had this course been pursued at the hearing, there would have been suitable opportunity to explore the problem through further testimony of the witnesses. The brief in this Court is hardly an appropriate substitute.

Since, however, a number of statements of fact are made bearing on the issue of depreciation allowance which call for reply in the interest of clarity, we shall advert briefly to the principal points which are now sought to be made.

a. The Commission's brief states (pp. 59–60) that the petitioners' witness estimated the depre-

ciable property in the rate base at $26,000,000, and that this testimony was "conjectural." In fact, as the witness explained, the figure $26,000,000 was simply the result of accepting the Commission's rate base figure of $28,088,332 and deducting therefrom the items which on their face show that they are nondepreciable property, *i. e.*, materials and supplies, cash working capital, and land (R. I, 163; cf. Ex. 2, R. I, 233). The amount of this nondepreciable property was conservatively estimated by the witness and his judgment on this point was not disputed by any Commission or Company witness or by the Commission itself in its opinion.

b. The Commission contends (p. 61) that while the sinking fund method was approved by this Court in the *Natural Gas Pipeline* case, 315 U. S. 575, a different method was used by the Federal Power Commission in the *Hope Natural Gas Company* case, No. 34, present Term, and was recommended by the National Association of Railroad and Utilities Commissioners. The difference in the use of these methods demonstrates precisely the propriety of the sinking fund method in the present case. That difference, as we attempted to show in our principal brief (pp. 37, 42, note 12), turns on the fact that under the sliding-scale arrangement no deduction from the rate base for accrued depreciation is made. In the *Hope* case, on the other hand, where the straight-line method was used, the amount of the deduction for accrued depreciation was one of the principal points in con-

troversy, and the Commission there arrived at a figure of $22,328,016 for accrued depreciation and depletion. In describing the sliding-scale arrangement as a "modified straight-line method" (p. 59) the brief characterizes as a modification the absence of the most essential feature of that method, the deduction of accrued depreciation from the base.

c. The Commission now attacks also the use by petitioners' witness of an average life of forty-three years for the property, and it is said (p. 62) that petitioners "offered no evidence that 43 years even approaches a proper life expectancy of the property." Again, as the proffered testimony made clear, that figure was accepted from the company's own depreciation rate figure of 2.2 percent used for corporate purposes (Tr. 974), and is more favorable to the company than would have been the use of 1.75 percent provided in the sliding scale. (See our brief, p. 42, note 13.) Thus the witness did not "blindly assume," as the Commission's brief asserts (p. 64) a life of forty-three years; instead, he took the most conservative figure afforded by the company's own accounting practice.

d. The Commission asserts (p. 63): "Whether the accrual allowed by the Commission or the reserve for depreciation was excessive or inadequate, the Petitioners did not know and made no effort to ascertain." It was precisely in an effort to ascertain this fact that petitioners sought

to examine the Commission's chief accountant on the subject of the depreciation allowance and were met with vigorous objection sustained by the Commission, the Chairman stating: "The objection is sustained. If the questions are confined to the proper calculation made under the sliding-scale arrangement which has been in effect for years, then there is no reason to object to it" (R. II, 394). This was the ruling of the Commission despite the fact that immediately before the objections were made and sustained, the chief accountant had acknowledged that a "truer or more correct consideration of accrued depreciation" would be secured by applying a 6½ instead of a 4 percent interest rate to the reserve balance (R. II, 390).

This effort to ascertain the fairness of the provision for depreciation was not a novel or ill-considered notion. Not only was the same problem involved in the *Natural Gas Pipeline* case, but it had been pointed out in 1936 in a scholarly analysis of the sliding-scale arrangement. See Bussing, *Public Utility Regulation and the So-Called Sliding Scale*, pp. 133, 136: "Under this arrangement, however, the company is permitted to earn 7% (7½% prior to January 1, 1933) on the reserve, but it pays only 4% into the depreciation account, thus retaining 3% as a virtual unearned increment. * * * An undepreciated rate base is fallacious and unjust

because it permits the company to earn a return on property provided by the consuming public. The Washington plan does not commit the full breach, however, for it requires the company to pay 4% for the use of property on which it is allowed to earn 7%." Those observations were addressed to the sliding-scale plan applicable to the Electric Company, but they are equally applicable here, except that the primary rate of return is 6½% rather than 7%, the respondent company having earned, however, an average of 6.86 percent under the arrangement through June 1941 (Ex. 11, R. II, 421). There is no evidence whatever that the reserve balance to which the rate is applied is held as a separate fund or invested in securities; as in the *Natural Gas Pipeline* case, it is part of the revenue-earning property.

2. The Commission objects to our showing that on the Company's own figures it was earning a return of 5% after all income and excess profits taxes, for the reason that we corrected the return from 4.87% to 5% by reason of an annual saving in taxes occasioned by a preferred dividend clearly not taken into account in the company's original calculations (see our brief, p. 79). The objection is a minor one, to the effect that the correction should not have been made on an annual basis but only for the second half of the test year, during which the tax credit came into op-

eration. In applying the correction to the Company's figures on an annual basis, we follow what appears to have been the treatment of federal income taxes in both the Company's and the Commission staff's calculations, whereby the higher rate in effect during 1942 was applied to the entire test year, including the second half of 1941, pursuant to the sliding-scale plan (R. I, 48).

3. The Commission impugns the conclusion of petitioners' witness that a rate reduction of $47,668 under the sliding scale was indicated by his calculation, because the dissenting commissioner concluded that a rate reduction of approximately $1,000,000 was justified (Br., pp. 69–70). The difference, of course, is accounted for by the fact that the calculation of the witness dealt with very limited corrections in the sliding scale, being confined to the use of the sinking fund method of depreciation and the disallowance of income taxes above 19%. The commissioner's calculation, on the other hand, embraced all elements entering into the rates, including the rate of return and very substantial items of claimed operating expenses, the classification of which was disputed.

4. The Commission (Br. p. 70) refers to our statement that bonds of the company were sold after the order of rate increase had been set aside by the district court, as a contention that "the setting aside of the order made the bonds market-

able." Of course our contention was that the order of increase had little if any effect on the present credit position of the company. In discussing the credit position of the company, the Commission makes a significant admission (Br. p. 72): "It was not the size of the increase nor the immediate effect on income that was important to the successful selling of securities. This was the first time under the sliding scale arrangement that an increase was indicated; hence the important question was whether the Commission would adhere to the arrangement. The integrity of the Commission was at stake." If any departure from the sliding scale arrangement threatened the credit of the company as a matter of principle, it is difficult to understand why the Commission was willing to disallow income taxes above 31%. It is difficult to understand, also, why the Commission in the hearing for the subsequent year was willing to modify the primary rate of return under the arrangement from 6½ percent to 5¾ percent (though allowing all federal income taxes except excess profits taxes). See Order No. 2682, November 8, 1943, pp. 17–18.

5. The Commission's brief (p. 70) challenges our statement that the Commission went outside the record to show in its opinion the earnings of the company's stock, and it is said that the finding was based on two finance dockets received

in evidence. But the opinion described earnings for twelve months through July 31, 1942 (R. I, 51) while the finance dockets were closed prior to April 30, 1942 (Tr. 2106–2223; 2235–2391; 2393–2543). The Commission did not pursue its investigation of earnings into the period up to November 16, 1942, when petitioner's motion for reconsideration was denied. We have pointed out in our brief (p. 50) on the basis of the record that for the first seven months of 1942 the income of the Company was on an upward trend as compared with the corresponding period of the previous year. This has not been challenged by the Commission or the Company. Had the Commission projected its inquiry into the earnings record before finally disposing of the case this trend would have been confirmed. In fact, the net operating revenues for 1942, after all expenses, including wages and all federal income taxes, proved to be in excess of those for 1941.

6. The Commission points out (Br. pp. 65–66) that one figure used by the dissenting commissioner in the 1943 case was later corrected; that figure, however, was not used in our brief, and its correction after the opinion was published is not material.

7. The Commission maintains (Br. pp. 62–63) that the depreciation method employed was twice approved by the District Court for the District of Columbia. While the sliding-scale arrange-

ment was approved as a whole, the unfairness of the depreciation method was not presented until the instant case and *United States by its Director of Procurement, Treasury Department, et al.* v. *Flanagan*, Nos. 20310, 20311, 20450, now pending in the district court. The most significant feature of the prior decisions is the emphasis on the Commission's continuing authority and responsibility to establish just and reasonable rates and to reexamine the sliding-scale arrangement if necessary to that end. In *Potomac Electric Power Co.* v. *Public Utilities Comm'n* (1931), Eq. No. 53475, Wheat, C. J., said:

> I do not wish to be understood, however, as upholding the contention that the order challenged is invalid because it is in disregard of the so-called Consent Decree of December 31, 1924. Neither that decree, nor the agreement upon which it was based, had, or could have had, under the statute, the effect of settling permanently the question of the proper rates to be charged by the plaintiff. That question presents a continuing problem, to be solved from time to time as it arises. So is the power of the Commission to solve it a continuing power, to be exercised from time to time according to the need. Correspondingly, the duty of the Commission is a continuing duty. Neither a court decree nor an agreement can deprive the Commission of

that power or absolve it from that duty. All this seems plain from a reading of the the statute.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.

PAUL A. FREUND,
Special Assistant to the Attorney General.

RICHARD H. FIELD,
Acting General Counsel,

DAVID F. CAVERS,
Assistant General Counsel,

HARRY R. BOOTH,
Utilities Counsel,
Office of Price Administration.

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